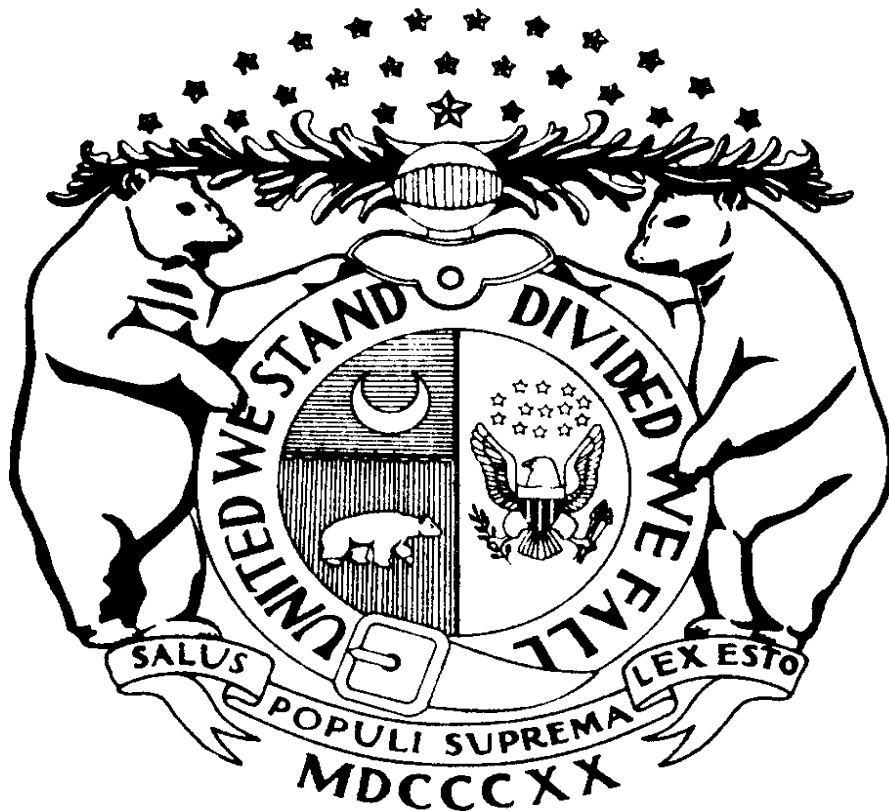


REPORT OF  
ASSOCIATION FINANCIAL EXAMINATION  
**CAMBRIDGE LIFE**  
**INSURANCE COMPANY**  
AS OF  
DECEMBER 31, 2001



STATE OF MISSOURI  
DEPARTMENT OF INSURANCE  
JEFFERSON CITY, MISSOURI

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Mission Viejo, CA  
June 13, 2003

Chairman of Financial Condition (EX4) Subcommittee  
Southeastern Zone Secretary  
Alfred W. Gross, Commissioner  
Virginia Bureau of Insurance

Midwestern Zone Secretary  
Sally McCarty, Commissioner  
Indiana Department of Insurance

Honorable Scott B. Lakin, Director  
Missouri Department of Insurance  
301 West High Street, 6 North  
Jefferson City, Missouri 65102-0690

Ladies and Gentlemen:

In accordance with your financial examination warrant, a full scope association financial examination has been made of the records, affairs and financial condition of

**Cambridge Life Insurance Company**

hereinafter referred to as such, as the "Company" or as "Cambridge Life". Its administrative office is located at 27725 Santa Margarita Parkway, Suite 220, Mission Viejo, California 92691, telephone number (949) 380-0233. This examination began on January 6, 2003, and concluded on the above date.

## **SCOPE OF EXAMINATION**

### **Period Covered**

The prior full scope association financial examination of American Life and Health Insurance Company was made as of December 31, 2001, and was conducted by examiners from the State of Missouri representing the Midwestern Zone of the National Association of Insurance Commissioners (NAIC).

The current full scope association financial examination covers the period from January 1, 1999, through December 31, 2001, and was conducted by examiners from the State of Missouri, representing the Midwestern Zone of the NAIC, with no other zones participating. A financial examination of American Life and Health Insurance Company (American L&H), an affiliate of Cambridge Life, was conducted by the Missouri Department of Insurance (MDI) concurrently with this examination.

This examination also included the material transactions and/or events occurring subsequent to the examination date which are noted in this report.

### **Procedures**

This examination was conducted using the guidelines set forth in the Financial Condition Examiners Handbook of the NAIC, except where practices, procedures and applicable regulations of the Missouri Department of Insurance and statutes of the State of Missouri prevailed.

The examiners relied upon information supplied by the Company's independent auditors, Deloitte & Touche LLP of Costa Mesa, California, from its audit covering the period from January 1, 2001, through December 31, 2001. This information included,

but was not limited to, attorneys' letters, bank account confirmations, and internal control evaluations.

### **Comments-Previous Examination**

Listed below are the comments, recommendations, and notes of the previous examination report, dated as of December 31, 1998, and the subsequent response or action taken by the Company.

#### **Corporate Records**

Comment: Although general approval of any and all legal actions during the year was noted in the minutes or actions, there was no evidence that major contracts and transactions were reviewed. It was recommended the minutes or actions specifically include the review and approval of major contracts and transactions during the year.

Company's Response: A report of material contracts and transactions will be prepared prior to all meetings of the board of directors. The report will be reviewed and the approval of the transactions will be included in the minutes of the meeting.

Current Findings: It appears the Company appropriately noted the review and approval of major contracts and transactions in the minutes during the current examination period.

#### **Intercompany Transactions**

Comment: The Company was directed to collect interest from American L&H for the 1997 loans, such interest to be at a fair and reasonable rate. The Company was also directed to file a Form D and an amended Form B to disclose the 1997 loans. The Company was further directed to document any future intercompany loans or advances with a written loan agreement that requires the payment of interest at a fair and reasonable rate. Also, the Company should take the necessary steps to ensure that it appropriately discloses any future intercompany loans and provide prior notice on any loans exceeding the threshold of RSMo 382.195 (Transactions within a holding company system).

Company's Response: Cambridge Life has received from American L&H interest on the loans which occurred in 1997. The rate used for this calculation was equal to the one year treasury rate plus 1%. The company has drafted an agreement for Short-Term Loan of Expenses which it will file for approval with the Department. No intercompany loans will be made prior to the approval of this agreement.

Current Findings: No evidence of any loans since 1997 was noted.

### **Fidelity Bond and Other Insurance**

Comment: It appeared that the Company did not have fidelity bond coverage. The Company should obtain a minimum of \$150,000 fidelity coverage as recommended by the NAIC guidelines for protection of its assets and its parent's investment in the Company.

Company's Response: Cambridge Life does have fidelity bond coverage for the period under examination.

Current Findings: The Company did obtain coverage along with several affiliates. However, the coverage does not meet the NAIC suggested minimum in 2001 or 2002. It was recommended that the Company increase its coverage to at least the minimum suggested by the NAIC guidelines.

### **Insurance Products and Related Practices**

Comment: The Company was directed to implement procedures to ensure that in the future, any administrator which should be classified as a managing general agent is identified in a timely manner through a quarterly review. The Company was further directed to ensure that it complies with all reporting and other provisions of 20 CSR 200-10 (Managing General Agents).

Company's Response: The company has implemented a quarterly review process to ensure that any administrator which should be classified as a managing general agent is identified. Cambridge Life will comply with all reporting and other provisions of 20 CSR 200-10 (Managing General Agents).

Current Findings: The Company did not have any agents that qualified as Managing General Agents as of December 31, 2001.

Comment: The Company was directed to ensure that it obtains signed agreements for all future administrators on a timely basis.

Company's Response: Cambridge Life will obtain signed agreements for all future administrators on a timely basis.

Current Findings: No problems were noted during the review for the current examination.

Comment: The Company was directed to perform, on a regular basis, periodic on-site premium and claims reviews of administrators with significant volume.

Company's Response: Cambridge Life has implemented procedures to perform quarterly audits of administrators with significant premium or claims volume.

Current Findings: As a December 31, 2001, the Company did not have any administrators with significant volume.

Comment: Early in 1999, Cambridge Life's management prepared a business plan and financial projections through 2002. The Company was directed to update and expand this document and submit a copy to the Missouri Department of Insurance.

Company's Response: Cambridge Life prepared and submitted a three to five year business plan with financial projections to the Missouri Department of Insurance.

Current Findings: The Company provided the examiners with a copy of its 2003 business plan.

## **Reinsurance**

Comment: The Company's Excess of Loss Agreement with AIG Life Insurance Company (AIG) did not contain an insolvency clause. The Company was directed to amend the agreement to include an insolvency clause which meets the approved wording as stated in Missouri Regulation 20 CSR 200-2.100(11)(A) (Credit for Reinsurance).

Company's Response: Cambridge Life asked AIG Life Insurance Company to amend their agreement to include an insolvency clause which meets the approved wording in Missouri Regulation 20 CSR 200-2.100(11)(A) (Credit for Reinsurance).

Current Findings: During the examination period, the Company obtained post-contract amendments adding the insolvency clause. This is unacceptable and does not meet the requirements of Missouri Regulation 20 CSR 200-2.100(11)(A) (Credit for Reinsurance). The Company is directed to ensure that reinsurance credits are not taken for any reinsurance agreement that does not fully comply with all the provisions of Missouri Regulation 20 CSR 200-2 (Credit for Reinsurance).



## **HISTORY**

### **General**

Cambridge Life was incorporated in the State of Texas on February 20, 1973, and was licensed and commenced business in 1974. On December 21, 1992, all outstanding shares of the Company were purchased by American Life and Health Insurance Company (American L&H) from The Chesapeake Life Insurance Company. In June of 1993, the Company's name was changed from National Motor Club Life and Accident Insurance Company to its current name, Cambridge Life Insurance Company.

Effective January 31, 1996, First Health Group Corporation (FHGC), formerly Health Care COMPARE Corporation, a Delaware corporation, purchased 100% of the stock of Creative Health Programs Administration, Inc. (CHP), a California corporation, and direct parent of American L&H. This transaction resulted in effectively making FHGC the ultimate parent of Cambridge Life

On January 1, 2002, the common stock of Cambridge Life was sold by American L&H to First Health Services Corporation (FHSC), a subsidiary of FHGC. On February 10, 2003, the MDI approved a dividend declaration from FHSC to FHGC in the form of the capital stock of Cambridge Life, effectively making FHGC the direct parent of Cambridge Life.

### **Capital Stock**

As of December 31, 2001, the Company was wholly owned by American Life and Health Insurance Company. The Company had 600,000 authorized shares of common stock with a par value of \$2.00. As of December 31, 2001, all 600,000 authorized shares

were issued and outstanding for a total balance of \$1,200,000 in the Company's common capital stock account.

Several changes occurred subsequent to the exam period. In 2002, the Company was sold to First Health Services Corporation (FHSC) and the par value of its common stock was changed. Specifically, on July 15, 2002, the Company amended the Articles of Incorporation to change the par value of the common stock from \$2.00 per share to \$3.34 per share. This change resulted in a total balance of \$2,004,000 in the Company's common capital stock account. Then in 2003, Cambridge Life became a direct subsidiary of FHGC when the stock of Cambridge Life was transferred to FHGC as a dividend from FHSC.

### **Dividends**

No dividends were paid to stockholders during the examination period.

### **Management and Control**

The directors elected and serving as of December 31, 2001, were as follows:

<u>Name and Address</u>	<u>Business Affiliation</u>
Alton Lee Dickerson Suisun, California	Executive Vice President Provider Networks First Health Group Corporation
Patrick Geary Dills Hinsdale, Illinois	Executive Vice President Sales First Health Group Corporation
Susan Flemming Naperville, Illinois	Senior Vice President, Product Management First Health Group Corporation
Lottie A. Kurcz Chicago, Illinois	Vice President American Life and Health Insurance Co. Cambridge Life Insurance Company Senior VP Strategic Business Development First Health Group Corporation

Susan Oberling  
Naperville, Illinois

Senior Vice President, Integrated Services  
First Health Group Corporation

James C. Smith  
Dallas, Texas

Chief Executive Officer  
First Health Group Corporation

David R. Studenmund  
Evanston, Illinois

Vice President Strategic Planning  
First Health Group Corporation

Joseph E. Whitters  
Glen Ellyn, Illinois

Treasurer and Vice President  
American Life and Health Insurance Co.  
Cambridge Life Insurance Company  
Vice President Finance, Treasurer, and CFO  
First Health Group Corporation

Edward L. Wristen  
South Barrington, Illinois

Secretary and Vice President  
American Life and Health Insurance Co.  
Cambridge Life Insurance Company  
President and Chief Operating Officer  
First Health Group Corporation

The officers elected and serving as of December 31, 2001, were as follows:

Jane Hannabach  
Lottie A. Kurcz  
Edward L. Wristen  
Joseph E. Whitters  
Susan T. Smith  
Mark Mosby  
Margaret Jones

President  
Vice President  
Vice President and Secretary  
Vice President and Treasurer  
Assistant Secretary  
Assistant Secretary  
Assistant Secretary

As of December 31, 2001, the Company had no active committees.

### **Conflict of Interest**

A conflict of interest statement is signed by the directors, officers and key employees each year. Signed statements were reviewed for the directors, officers and key employees during the examination period. No material conflicts were revealed.

### **Corporate Records**

The Articles of Incorporation and Bylaws of the Company were reviewed for the examination period. The Articles were amended on July 28, 2000, to change the principal office address to: 27725 Santa Margarita Parkway, Suite 220, Mission Viejo, CA 92691. Subsequent to the exam period, on June 7, 2002, the Articles were amended to change the par value of the common stock from \$2.00 per share to \$3.34 per share. The Bylaws were not amended or restated during the examination period.

The shareholder and the board of directors do not always have formal meetings. When meetings are not held, all actions by the shareholder or the board of directors are a result of “Unanimous Written Consent of the Sole Shareholder” (in lieu of meeting) and “Unanimous Written Consent of the Board of Directors” (in lieu of meeting). The stockholder actions were signed by Edward Wristen, on behalf of American L&H, and either Teresa DiMarco or Edward Wristen, on behalf of FHSC. All directors sign the actions taken by the board of directors.

### **Acquisitions, Mergers and Major Corporate Events**

See the “General” portion of the History section of this examination report.

### **Surplus Debentures**

As of December 31, 2001, the Company did not have any surplus notes issued or outstanding.

## **AFFILIATED COMPANIES**

### **Holding Company, Subsidiaries and Affiliates**

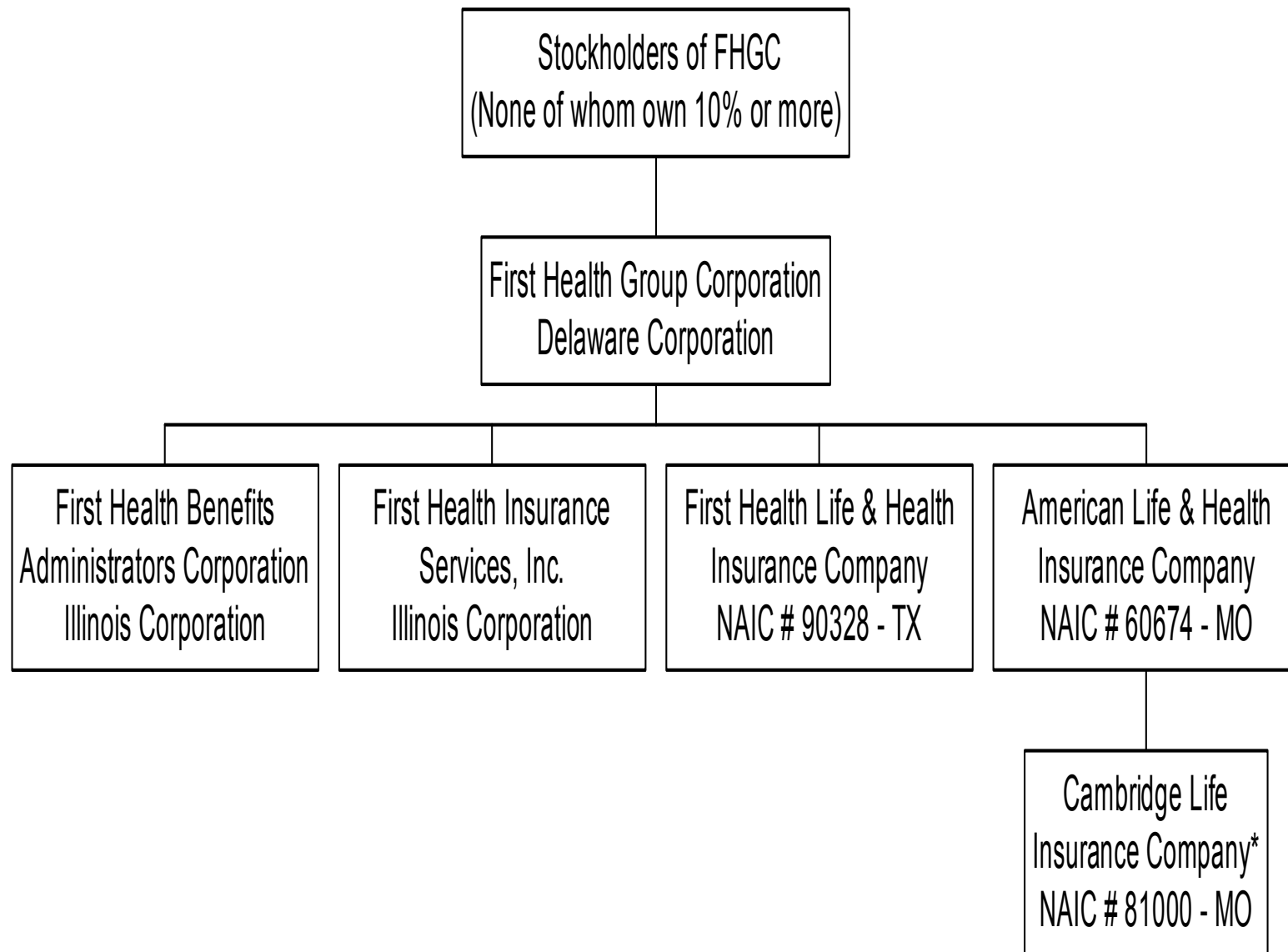
Cambridge Life Insurance Company is a member of an Insurance Holding Company System as defined by Section 382.010 RSMo (Definitions). As of December 31, 2001, Cambridge Life was a wholly owned subsidiary of American Life and Health Insurance Company (American L&H), a Missouri-domiciled life and health insurance company. (Cambridge Life was subsequently sold in 2002 to another affiliate, First Health Services Corporation (FHSC), a Virginia corporation. In 2003, Cambridge Life became a direct subsidiary of FHGC through a dividend of the capital stock of Cambridge Life from FHSC to FHGC.) American L&H is a wholly owned subsidiary of First Health Group Corporation, a Delaware corporation. First Health Group Corporation (FHGC) is an independent provider of medical cost management services including a national Preferred Provider Organization, various medical review programs, and computer assisted repricing services.

FHGC is a publicly-held company traded on the NASDAQ National Market under the symbol FHCC. As of December 31, 2001, there were 100,022,000 shares of FHGC common stock outstanding. No individual shareholder, directly or beneficially, owned 10% or more of the outstanding shares.

Insurance Holding Company System Registration Statements have been filed annually by American L&H with the State of Missouri on behalf of itself and Cambridge Life during the examination period.

### **Organizational Chart**

The following organizational chart partially depicts the holding company system of Cambridge Life Insurance Company as of December 31, 2001. The only non-insurance company subsidiaries of First Health Group Corp. included in the chart are those who have intercompany agreements with Cambridge Life.



\* Subsequent to the examination date, Cambridge Life was sold to First Health Services Corporation (FHSC). In 2003, Cambridge Life became a direct subsidiary of FHGC when the stock of Cambridge Life was transferred to FHGC as a dividend from FHSC.

### **Intercompany Transactions**

Cambridge Life has entered into various intercompany agreements including:

1.     Type:           Administrative Agreement  
  
       Parties:       American L&H and Cambridge Life  
  
       Effective:     June 1993. Amended January 1998.  
  
       Terms:         American L&H administers accident and health policies of Cambridge Life for a fee based on a percentage (11.57%) of the gross premium collected for Cambridge Life. American L&H performs all claims, underwriting, billing, and actuarial data services in connection with this business.
  
2.     Type:           Cost Sharing Agreement  
  
       Parties:       American L&H and Cambridge Life  
  
       Effective:     January 1993. Amended February 1997, January 1998, and January 2000.  
  
       Terms:         American L&H provides office space, computer equipment, office equipment and office supplies for fixed monthly fees. American L&H also provides executive personnel in exchange for the reimbursement of a percentage of executive compensation based on time spent by the executives on Cambridge Life.
  
3.     Type:           Administrative Services Agreement  
  
       Parties:       First Health Benefits Administrators Corp. (FHBAC, previously HealthCare COMPARE Administrative Services, Inc. (HCCAS) and Cambridge Life  
  
       Effective:     September 1998. (Replaces October 1996 agreement.)  
  
       Terms:         FHBAC serves as a Third-Party Administrator (TPA) for Cambridge Life, administering primarily stop loss policies. Fees paid to FHBAC under this agreement are 3% of the premium on policies administered. This agreement is currently inactive as these types of policies are not currently being written by Cambridge Life.



4.     Type:           Agent Agreement

      Parties:       First Health Insurance Services, Inc. (FHISI) and Cambridge Life

      Effective:     September 1998. (Replaces Jan. 1996 Commission Agreement.)

      Terms:        First Health Insurance Services, Inc. serves as an agent of Cambridge Life, marketing group health and stop loss policies for a commission of up to 20%. This agreement is currently inactive as these types of policies are not currently being written by Cambridge Life.
5.     Type:           Client Contract

      Parties:       First Health Group Corp. and Cambridge Life

      Effective:     November 1995. Amended and restated January 1996. Amended September 1998.

      Terms:        First Health Group Corp. provides Cambridge Life with access to managed care services for Cambridge Life to offer with its managed care insurance products. Usage-based fees are charged for the managed pharmacy system services, passed-through at the rate charged by the Pharmacy Administrator. No separate fees are due under this agreement for medical cost management services as reimbursement for these services is contained in the reimbursement Cambridge Life pays under the Agreement for Administrative and Financial Services and Overhead Allocation discussed below.
6.     Type:           Agreement for Administrative and Financial Services and Overhead Allocation

      Parties:       First Health Group Corp. and Cambridge Life

      Effective:     September 1998. (Replaces October 1996 agreement.)

      Terms:        First Health Group Corp. provides medical cost management, legal, administrative, and financial services to Cambridge Life for a monthly fee of \$10,000. The contract allows for this fee to be waived annually by FHGC if the pre-tax income of Cambridge Life, prior to the \$120,000 annual fee, is less than \$240,000. The \$120,000 annual fee was waived for all three years covered by this examination (1999, 2000, and 2001).

Following is a table of amounts incurred under the above described Cambridge Life intercompany agreements. This table shows the other party to the agreement, the agreement name, and the dollar amount incurred by Cambridge Life under each agreement for 1999, 2000, and 2001.

	2001	2000	1999
American Life and Health Insurance Co.:			
Administrative Agreement	\$10,032	\$10,967	\$11,719
Cost Sharing Agreement	44,220	52,805	117,480
First Health Benefits Administrators Corp.:			
Administrative Services Agreement	(590)	3,174	12,177
First Health Insurance Services, Inc.:			
Agent Agreement	0	10,581	43,964
First Health Group Corporation:			
Client Contract <sup>1</sup>	0	0	0
Admin, Fincl Serv & O/H Alloc <sup>2</sup>	0	0	0
TOTALS	<u>\$53,662</u>	<u>\$77,527</u>	<u>\$185,340</u>

Effective January 1, 2002, Cambridge Life entered into a Tax Allocation agreement with First Health Group Corporation. Under this agreement, Cambridge Life will file a consolidated income tax return with FHGC and FHSC in 2002 and subsequent years.

American L&H ceded individual life business to Cambridge Life under a quota share reinsurance contract effective July 1, 1993. In 2002, American L&H and Cambridge Life entered into an assumption reinsurance agreement whereby Cambridge assumes health business from American L&H. These agreements are discussed under the Reinsurance section of this examination report.

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<sup>1</sup> The only fees paid under this agreement are those fees charged by the Pharmacy Administrator to FHGC and passed through to Cambridge Life based on the actual amount paid by FHGC.

<sup>2</sup> The \$120,000 annual fee to FHGC was waived for 1999, 2000, and 2001.

## **FIDELITY BOND AND OTHER INSURANCE**

The Company is a named insured, along with two of its affiliates, on a financial institutions bond providing coverage with a \$300,000 limit. The NAIC suggested minimum coverage for the covered companies was \$400,000 as of December 31, 2001, and \$500,000 as of December 31, 2002. It is recommended the Company increase its bond to at least the suggested minimum recommended by the NAIC.

Cambridge Life is a named insured on the following insurance policies with its ultimate parent, First Health Group Corporation and affiliates:

General Liability	Property
Workers' Compensation	Errors and Omissions
Employment Practices Liability	Directors and Officers Liability
Commercial Automobile	Umbrella

## **PENSION, STOCK OWNERSHIP AND INSURANCE PLANS**

Cambridge Life does not have any employees. All personnel are employed by an affiliate. A variety of standard benefits are provided to these employees including medical, dental, group life, accidental death and dismemberment coverage, 401k plan, tuition reimbursement and a stock option plan. The Company does not have a direct obligation for these benefits. It appears that the Company has properly reported any related liability in its intercompany account.

## **STATUTORY DEPOSITS**

### **Deposits with the State of Missouri**

The funds on deposit with the Missouri Department of Insurance as of December 31, 2001, as reflected below, were sufficient to meet the capital deposit requirements for the State of Missouri in accordance with Section 376.290 RSMo (Trust Deposits). The

Company's required deposit for Missouri is \$600,000. The funds on deposit as of December 31, 2001, were as follows:

Type of Security	Par Value	Market Value	Statement Value
U.S. T-Note	\$ 190,000	\$ 198,253	\$ 195,255
U.S. T-Note	209,000	207,106	201,843
U.S. T-Note	400,000	417,375	401,606
U.S. T-Note	700,000	768,031	700,613
	<u>\$ 1,499,000</u>	<u>\$ 1,590,765</u>	<u>\$ 1,499,317</u>

### **Deposits with Other States**

The Company also has funds on deposit with other states in which it is licensed to satisfy their statutory deposit requirements. The funds on deposit as of December 31, 2001, were as follows:

State	Type of Security	Par Value	Market Value	Statement Value
Arkansas	Bond – Pacific Bell	\$ 140,000	\$ 140,603	\$ 143,684
Florida	Bond – Coca Cola Etrp. Inc.	125,000	143,510	125,019
Florida	Bond – Trav P&C Corp.	100,000	109,843	98,918
New Mexico	Bond – JP Morgan & Co.	120,000	125,046	122,227
North Carolina	U. S. T-Note	120,000	129,113	121,690
South Carolina	Bond – JP Morgan & Co.	185,000	195,055	183,814
		<u>\$ 790,000</u>	<u>\$ 843,170</u>	<u>\$ 795,352</u>

## **INSURANCE PRODUCTS AND RELATED PRACTICES**

### **Territory and Plan of Operations**

The Company is licensed with the Missouri Department of Insurance under RSMo Chapter 376 for life, annuities and endowments, and accident and health insurance. Cambridge Life is licensed to transact the business of insurance in twenty-three states. However, during the examination period, Cambridge Life wrote business in less than half those states. By 2001, Cambridge Life's direct premium was spread between three states: Arizona, Tennessee, and Texas. In 2002, Cambridge Life had direct premiums in these three states plus Missouri, due to the assumption of Missouri Consolidated Health Care Plan (MCHCP) health business from its affiliate, American L&H.

The Company's primary product during the examination period was small group health with a minimal amount of disability and ordinary life. A significant new product was added in 2002 with the assumption of Missouri Consolidated Health Care Plan (MCHCP) health business from its affiliate, American L&H. Cambridge Life's premium volume declined significantly from the prior exam period due to the shifting of stop loss business to an affiliate, First Health Life & Health, and the May 31, 1999 termination of an agent agreement with Equitable Plan Services (EPS) when the business EPS produced proved to be unprofitable.

Cambridge Life has a license application pending with the New York Department of Insurance. If the Company receives a New York license, First Health Group Corporation plans for Cambridge Life to write all the New York insurance business for the group. No other member of FHGC is currently licensed in New York. New York

business written would likely be of an ancillary nature, such as dental or disability coverage.

### **Policy Forms & Underwriting**

### **Advertising & Sales Material**

### **Treatment of Policyholders**

The Missouri Department of Insurance (MDI) has a market conduct staff, which performs a review of these issues and generates a separate market conduct report. However, the MDI has not performed a market conduct examination of the Company.

A cursory review was made of several market conduct related areas of the Company during the examination. No problems were noted.

## **REINSURANCE**

### **General**

The Company's reinsurance and premium activity for the three-year period ending December 31, 2001, is detailed below:

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Direct Premiums	\$180,114	\$287,248	\$1,190,597
Assumed Premiums:			
Affiliates	13,194	13,641	16,591
Non-affiliates	0	0	0
Ceded Premiums:			
Affiliates	0	0	0
Non-affiliates	<u>6,628</u>	<u>40,704</u>	<u>211,863</u>
Net Premiums Written	<u>\$186,680</u>	<u>\$260,185</u>	<u>\$995,325</u>

### **Assumed**

On July 1, 1993, the Company entered into an agreement with its affiliate, American L&H, wherein Cambridge Life assumes 10% of American L&H's ordinary life

business. Subsequent to the exam period, on October 1, 2002, the Company entered into an Assumption Reinsurance Agreement with American L&H, wherein American L&H affected a complete novation from American L&H to Cambridge Life in respect to every health and disability insurance policy, and rider, relating to policyholders or contract-holders residing in the state of Missouri, such that all obligations related to these policies or contracts are transferred from American L&H to Cambridge Life.

### **Ceded**

An Excess of Loss Agreement covering medical and dental benefits was executed with AIG Life Insurance Company (AIG) effective May 1, 1996 and renewed annually through April 30, 2003. This agreement was not renewed May 1, 2003. The specific retention amount per covered person per policy year was \$125,000 with a yearly aggregate limit of \$875,000. The yearly agreement does not contain an insolvency clause until an amendment is added after the end of the policy year. Since it occurs after the end of the policy-year, this post-contract amendment adding the insolvency clause is unacceptable and does not meet the requirements of Missouri Regulation 20 CSR 200-2.100(11)(A) (Credit for Reinsurance). The lack of an acceptable insolvency clause for this contract was also noted in the prior examination. The Company is directed to ensure that reinsurance credits are not taken for any reinsurance agreement that does not fully comply with all the provisions of Missouri Regulation 20 CSR 200-2 (Credit for Reinsurance).

Effective April 1, 1994, the Company entered into a quota-share reinsurance agreement with American Labor Life Insurance Company. Under this agreement, Cambridge Life cedes 50% of all policies of life, accident and health insurance written

after April 1, 1994, through its third party administrator, Tower Insurance Services, Incorporated. Minimal activity was reported under this contract.

Cambridge Life has several other treaties that have been terminated and are now in run-off. These treaties currently involve minimal premium and activity.

The Company is contingently liable for all reinsurance losses ceded to others. This contingent liability would become an actual liability in the event that an assuming reinsurer should fail to perform its obligations under its reinsurance agreement with the Company.

### **ACCOUNTS AND RECORDS**

Financial statements of the Company were audited by the CPA firm, Deloitte & Touche LLP, Costa Mesa, California, for the years ending December 31, 2001, 2000, and 1999.

Loss reserves of the Company were reviewed and certified by Jon Paul Dorris, FSA, MAAA, of West Coast Actuarial and Financial Consultants, Inc. for the years ending December 31, 2001, 2000, and 1999.

### **FINANCIAL STATEMENTS**

The following financial statements, with supporting exhibits, present the financial condition of the Company for the period ending December 31, 2001. Any examination adjustments to the amount reported in the Annual Statement and/or comments regarding such are made in the "Notes to the Financial Statements". (The failure of any column of numbers to add to its respective total is due to rounding or truncation.)



There may have been differences found in the course of this examination, which are not shown in the “Notes to the Financial Statements”. These differences were determined to be immaterial, concerning their effect on the financial statements. Therefore they were communicated to the Company and/or noted in the workpapers for each individual Annual Statement item.

### Analysis of Assets

	ASSETS	NON- ADMITTED ASSETS	NET ADMITTED ASSETS
Bonds	\$3,866,998		\$3,866,998
Policy loans	2,295		2,295
Cash and short-term investments	154,469		154,469
Reinsurance ceded	10		10
Federal income tax recoverable	31,919		31,919
Life insurance premiums deferred and uncollected	848		848
Accident and health premiums due and unpaid	8,932		8,932
Investment income due and accrued	58,675		58,675
Receivable from parent, subsidiary and affiliates	10,039		10,039
Aggregate write-ins for other than invested assets	5,000		5,000
<b>Total assets</b>	<u><u>\$4,139,185</u></u>	<u><u>\$0</u></u>	<u><u>\$4,139,185</u></u>

### Liabilities, Surplus and Other Funds

Aggregate reserve for life policies and contracts	\$ 366,088
Aggregate reserve for accident and health policies	602
Policy and contract claims:	
Life	14,213
Accident and health	53,129
Premium and annuity considerations received in advance	341
Surrender value on canceled policies	160
Interest maintenance reserve	2,203
Commissions to agents due or accrued	3,305
General expenses due or accrued	27,385
Taxes, licenses and fees due or accrued, excluding fed'l income taxes	129,981
Amounts withheld or retained by company as agent or trustee	5,760
Asset valuation reserve	8,884
Funds held under reinsurance treaties with unauthorized reinsurers	5,000
Payable to parent, subsidiaries and affiliates	2,754
<b>Total liabilities</b>	<b>619,805</b>
Common capital stock	1,200,000
Surplus notes	-
Gross paid in and contributed surplus	2,500,000
Unassigned funds (surplus)	(180,620)
<b>Surplus as regards policyholders</b>	<b>3,519,380</b>
<b>Total liabilities and surplus</b>	<b>\$ 4,139,185</b>

### Statement of Income

Premium and annuity considerations for life and A&H policies	\$185,107
Net investment income	259,311
Amortization of interest maintenance reserve	163
Commissions and expense allowances on reinsurance ceded	54
<b>Total</b>	<b><u>444,635</u></b>
Death benefits	22,127
Disability benefits and benefits under accident and health policies	252,103
Surrender benefits and withdrawals for life contracts	10,074
Increase in aggregate reserves for life and A&H policies and contracts	<u>(19,724)</u>
Total	264,580
Commissions on premiums and annuity considerations	33,357
General insurance expenses	140,430
Insurance taxes, licenses and fees, excluding federal income taxes	<u>82,700</u>
<b>Total</b>	<b><u>521,067</u></b>
<b>Net gain from operations before federal income taxes</b>	<b>(76,432)</b>
Federal income taxes incurred	<u>0</u>
<b>Net gain from operations after federal income taxes</b>	<b><u>\$ (76,432)</u></b>
Net realized capital gains or (losses) less capital gains tax	<u>(128)</u>
<b>Net Income</b>	<b><u><u>\$ (76,560)</u></u></b>

### Capital and Surplus Account

<b>Capital and surplus, December 31, 2000</b>	\$ 3,564,698
Net income	(76,560)
Change in net deferred income tax	22,495
Change in asset valuation reserve	(676)
Cumulative effect of changes in accounting principles	9,424
<b>Capital and surplus, December 31, 2001</b>	<b><u>\$ 3,519,381</u></b>

## **NOTES TO THE FINANCIAL STATEMENTS**

NONE

### **EXAMINATION CHANGES**

NONE

### **GENERAL COMMENTS AND/OR RECOMMENDATIONS**

#### **Fidelity Bond and Other Insurance (Page 16)**

The Company is a named insured, along with two of its affiliates, on a financial institutions bond providing coverage with a \$300,000 limit. The NAIC suggested minimum coverage for the covered companies was \$400,000 as of December 31, 2001, and \$500,000 as of December 31, 2002. It is recommended the Company increase its bond to at least the suggested minimum recommended by the NAIC.

#### **Reinsurance Ceded (Page 20)**

During the examination period, the Company obtained yearly amendments to its Excess of Loss Agreement with AIG Life Insurance Company, adding an insolvency clause after the end of the policy year. Since it occurs after the end of the policy year, this post-contract amendment is unacceptable and does not meet the requirements of Missouri Regulation 20 CSR 200-2.100(11)(A) (Credit for Reinsurance). The Company is directed to ensure that reinsurance credits are not taken for any reinsurance agreement that does not fully comply with all the provisions of Missouri Regulation 20 CSR 200-2 (Credit for Reinsurance).

## **SUBSEQUENT EVENTS**

In 2002, American Life and Health Insurance Company sold Cambridge Life Insurance Company to another affiliate, First Health Services Corporation (FHSC), a Virginia corporation. In 2003, Cambridge Life became a direct subsidiary of FHGC through a dividend of the capital stock of Cambridge Life from FHSC to FHGC.

October 1, 2002, American L&H and Cambridge Life entered into an assumption reinsurance agreement whereby Cambridge Life assumes Missouri Consolidated Health Care Plan (MCHCP) health business from American L&H. These agreements are discussed under the Reinsurance section of this examination report.

In 2002, FHGC contributed \$2,393,000 to Cambridge Life. This contribution was made to support Cambridge Life's efforts to become licensed in the State of New York.

Effective January 1, 2002, CLIC entered into a Tax Allocation Agreement with FHGC to file consolidated tax returns for years 2002 and after.

### ACKNOWLEDGMENT

The assistance and cooperation extended by the officers and the employees of Cambridge Life Insurance Company during the course of this examination is hereby acknowledged and appreciated. In addition to the undersigned, Angela Campbell, AFE, examiner for the Missouri Department of Insurance, participated in this examination.

### VERIFICATION

State of Missouri     )  
                                  )  
County of             )

I, Vicki L. Denton, CFE, on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only facts appearing upon the books, records or other documents of the Company, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiners find reasonably warranted from the facts.

\_\_\_\_\_  
Vicki L. Denton, CFE  
Examiner-In-Charge  
Missouri Department of Insurance

Sworn to and subscribed before me this \_\_\_\_\_ day of \_\_\_\_\_, 2003.

My commission expires: \_\_\_\_\_  
Notary Public

### SUPERVISION

The examination process has been monitored and supervised by the undersigned. The examination report and supporting workpapers have been reviewed and approved. Compliance with NAIC procedures and guidelines as contained in the Financial Condition Examiners Handbook has been confirmed.

\_\_\_\_\_  
Frederick G. Heese, CFE, CPA  
Audit Manager  
Missouri Department of Insurance